China’s retail market will not overtake the US market in 2020 after all. Here’s why.

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Ethan Cramer-Flood

Take heart, US retail salespeople: Despite premature calls to the contrary, it turns out the US will remain the most lucrative retail market in the world this year and for some years to come.

For a while, though, we saw things differently. Back in Q2, during the height of the coronavirus-driven economic collapse in the US, it became clear that China’s economy would likely come through its recessionary phase more quickly than the US would. Due largely to this observation—which turned out to be accurate—our forecasters concluded that the US retail market would likely contract much more severely than would China’s in 2020.

The data at the time suggested that, by virtue of this unprecedented US decrease, China would back-door its way into the No. 1 global ranking for overall retail sales by the end of 2020. In other words, even though China’s consumer market was in line for a terrible year as well, it would still leap to the top spot because of the more precipitous spending decline in the US. We proclaimed our forecast as such.

However, this scenario has not played out as anticipated. While China’s performance will turn out to be relatively close to our initial

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prediction, the US has done an almost unbelievable about-face when it comes to consumer spending. We now forecast that US retail sales will, incredibly, grow by 0.8% this year, reaching $5.506 trillion in total spending. This represents a net upward increase of 11.2 percentage points from our April forecast of a 10.5% decline—equating to $612.20 billion more in sales than we expected (and a $41.20 billion increase over 2019).

By contrast, we now estimate that China's retail market will decline by 2.9% in 2020, which is relatively close to our Q2 estimate that spending would decline by 4.0% this year. This equates to a decline from $5.283 trillion in 2019 to $5.130 trillion in 2020. Meaning that, against all odds, the US will widen its lead on China this year, rather than lose it.

Overall, China's economic recovery outperformed expectations, but very little of that boost trickled to retail sales. In the US, meanwhile, the economy tanked as expected, but retail spending somehow expanded.

So, what happened?

These contradictory results illuminate the fundamental structural differences between how the US and China run their respective

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economies. The final figures also speak to the very different ways that the two governments went about trying to rescue their countries from economic disaster in 2020. Reader, beware: We're going to get a little wonky here.

China Focuses on Supply, Not Demand

In China, the economic development model is oriented around investment, construction, manufacturing, infrastructure build-outs, real estate development, and giant state-owned (or state-directed) enterprises that undertake projects in service of these goals. Therefore, in times of economic stress, China's best bet is generally to juice investment activity by major corporate players by implementing policies that help energize these constituencies.

This is what happened in 2020: China's recovery and stimulus packages centered on supporting strained businesses rather than struggling households or individuals. Beijing's policymakers concentrated on:

- Cutting business taxes.
- Reducing regulatory fees.
- Lowering interest rates for small and medium-sized enterprises.
- Creating new tax exemptions.
- Waiving contribution requirements for social welfare funds.
- Lowering prices for business inputs like local utility costs.

Central bank regulators also worked hard to buttress the finances of overwhelmed local and provincial governments, who in turn were obligated to use new instruments like localized "special-purpose bonds" to fund the same set of supply-side stimulus activities prioritized by the national leadership.

Collectively, this set of stimuli successfully pulled China's economy out of its historically bad Q1 rut. In Q1, China reported its GDP declined by 6.8% year over year. However, by Q2, the tables had already flipped to positive growth of 3.2%. By Q3, China posted 4.9%

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growth. And in Q4, the nation will likely return to growth rates approaching its 2019 trend lines.

This all sounds great, but what these policies didn't do was put money in the pockets of regular people. China's unemployment insurance, for instance, is so minimal as to be nearly inconsequential by global standards. Beijing sent no stimulus checks to households or individuals either. And migrant laborers who lost their jobs received little support that may have lead them to maintain their consumption habits.

While China did marginally enhance social benefits for these vulnerable groups during the crisis, those increases were coming from such a low base that they did not make much of a difference. As a result, household spending languished and did not bounce back nearly as quickly as the rest of the economy. China's retail figures finally turned positive in August, many months after GDP had turned around.

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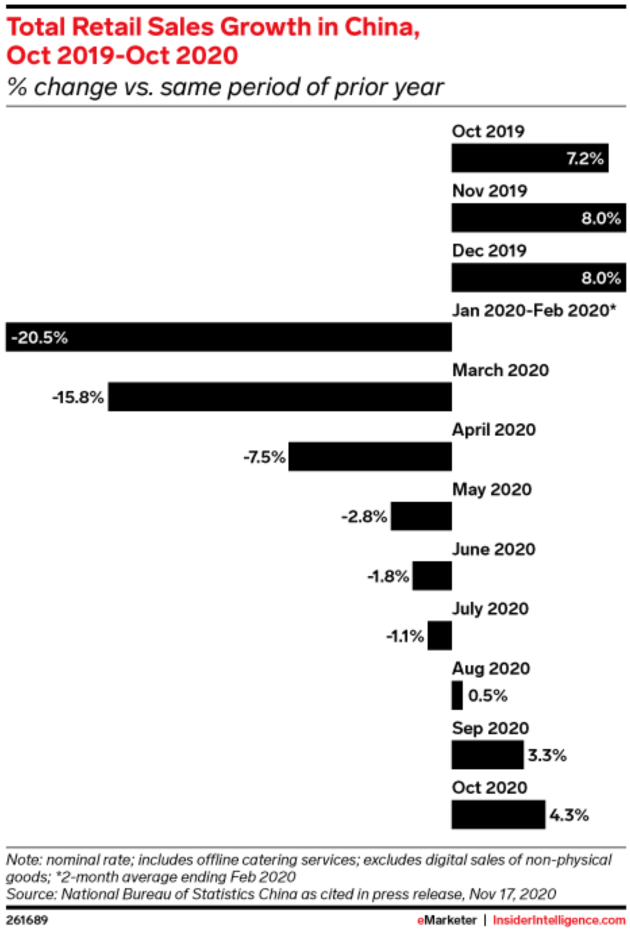

The Chinese government's massive spending, lending, and financing activities purposefully accrued benefits to the corporate world rather than to consumers. This approach was designed to support employment (which it did, to some degree), but it did not buttress consumer confidence, nor did it ensure regular people would have enough money in their pockets to continue spending on retail goods at pre-pandemic levels.

Hence, China's GDP growth outperformed, but its consumers still had a bad year.

The US Focuses on Demand, Not Supply

In the US, the story played out almost exactly in reverse, but with some additional unexpected developments. The US economy is overwhelmingly consumer-centric, and the health and well-being of its annual GDP performance tends to mirror the degree to which

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people in the US are able to—and choose to—spend money on goods and services.

Therefore, when the US is facing dire economic straits, policymakers tend to lean toward putting money directly in people's pockets to juice the overall economy. This sometimes comes in the form of personal income tax cuts, but that approach takes a while to bear fruit. More immediate results come from direct distributions, which in the case of 2020 came mainly in the form of enhanced and extended unemployment benefits and the notorious Q2 stimulus checks.

US Retail Ecommerce and Total Retail Sales, Q3 2019-Q3 2020

	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Retail ecommerce sales (billions)	**$153.22**	**$156.58**	**$160.41**	**$211.60**	**$209.53**
—% change vs. prior quarter	4.7%	2.2%	2.4%	31.9%	-1.0%
—% change vs. same period of prior year	17.3%	16.6%	14.8%	44.5%	36.7%
—% of total retail sales	11.2%	11.3%	11.8%	16.1%	14.3%
Total retail sales (trillions)	**$1.373**	**$1.380**	**$1.364**	**$1.311**	**$1.469**
—% change vs. prior quarter	1.0%	0.5%	-1.1%	-3.9%	12.0%
—% change vs. same period of prior year	3.8%	3.8%	2.1%	-3.5%	7.0%

Note: figures are unadjusted; excludes financial brokers and dealers, ticket sales agencies and travel
Source: US Department of Commerce, "Quarterly Retail E-commerce Sales, 3rd Quarter 2020," Nov 19, 2020

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By some measures, these policies worked pretty well, at least in terms of supporting aggregate consumer spending. In Q2, even as the overall economy collapsed (a 31.4% decline quarter over quarter for GDP), US consumers kept the retail sector nearly afloat by pouring cash into ecommerce channels at unprecedented rates. By Q3, US retail sales bounced back from a quarter-over-quarter decline of 3.9% in Q2 to 12.0% growth. This in turn supported a relative bounce-back for the US economy in Q3 and explains why so many policymakers in DC are eager to negotiate a second stimulus package before the positive effects of the first one wear off entirely. (The International Monetary Fund still expects US GDP to contract by 4.3% this year.)

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The first stimulus package is a big part of why retail sales held up in the US in 2020, and why the US retail market will stay ahead of China's. But something else unexpected happened, too.

Social Distancing Changes Spending Behavior, to Retail's Benefit

Stimulus money isn't enough to explain the degree to which US retail spending held up in 2020. Additional money came from somewhere else, and this explanation will likely be the story of the year.

As it turns out, due to the pandemic and various lockdowns, quarantines, and the general fear of going outside, people in the US overwhelmingly and disproportionately reduced their spending on services this year. Then, rather than save this unspent money (as might have been expected during a recession), many US consumers turned around and binge-spent their newly available cash on retail goods.

The revelation of 2020 is the degree to which the pandemic shattered the services sector to the benefit of the retail sector. Meaning, economic pain accrued overwhelmingly to US restaurants, bars, entertainment venues, hotels, airlines, travel companies, educational institutions, theme parks, movie theaters, salons, etc.—and most of the money that normally would've gone to these service providers instead went to goods retailers. That "extra" money, along with the stimulus, explains what happened this year.

To put it succinctly: Nobody went anywhere or did anything in 2020, and instead they used their activities budgets to buy stuff.

In retrospect, this phenomenon should have been predictable, but most economic analysts and forecasters missed it. While the economic disaster was real, GDP did collapse for a while, unemployment spiked, and many households did indeed increase their savings rates to some degree. The pool of unspent services money was so vast that even a portion of it, when redirected to consumer goods, created enough new spending to move US retail

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into positive territory for the year and to maintain its position as the No. 1 market in the world.

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